

**Transco
Distribution**

Procurement Guidelines for Distribution

May 2005 version 1.0

PROCUREMENT GUIDELINES PRINCIPLES STATEMENT

Modification History

Modification Reference Number	Date of Implementation	Notes

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PART A: INTRODUCTION

1. Purpose of Document

This document sets out the Procurement Guidelines (“the Guidelines”) which Transco Distribution is required to establish in accordance with Standard Special Condition D5 (the Special Condition) of its Gas Transporters (GT) Licence (the Licence). The purpose of the Guidelines is to set out the kinds of System Management services/tools which might have a role in respect of gas, energy and/or capacity management associated with Transco Distribution’s pipe-line System, which Transco Distribution may be interested in buying and selling in pursuance of its System Management role. Transco, through its Transmission business, produces a similar document associated with the National Transmission System.

The Guidelines cannot cover every possible situation that Transco Distribution is likely to encounter, but rather represent a generic statement of the procurement principles it expects to follow and an appreciation of the sorts of tools it might wish to develop and utilise from time to time.

For the avoidance of doubt the Guidelines refer to the DN’s system balancing role and do not include energy balancing activities.

The Guidelines make reference to a number of definitions contained in the Network Code. In the event that any of the relevant provisions in the Network Code are amended it may become necessary to modify the Guidelines in order that they remain consistent with the Network Code.

In any event, where statutory obligations or the provisions of the Network Code are considered inconsistent with any part of these Guidelines, then the relevant statutory obligation and/or Network Code provision will take precedence.

The document covers Transco Distribution’s distribution system and references to pipeline and network should be construed accordingly. Transco Distribution’s distribution system covers the following networks, as defined in Special Condition E2A of its licence:

- North West Network
- West Midlands Network
- East of England Network
- London Network

Unless defined in the Guidelines, terms used herein shall have the same meanings given to them in its GT Licence or Network Code as the case may be. The latest version of this document is expected to be available electronically from NGT’s Transco website. Alternatively a copy may be requested from:

Peter Rayson
Commercial Manager
UK Distribution
National Grid Transco
NGT House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA
Tel. 01926 655178
E-mail: peter.rayson@uk.ngrid.com

Previous versions of the Procurement Guidelines will be held for reference purposes by the above contact.

2. Transco Distribution Performance

In relation to responding to the DN incentive schemes and performing functions described in this document, Transco Distribution will seek at all times to follow the guidelines contained within and shall seek to act in good faith and in a reasonable and prudent manner in its dealings save to the extent that:

- there is any standard of performance already provided for by any statute, regulation or Licence condition to which Transco Distribution is subject; or
- the continued exercise of the discretions or functions described herein could cause Transco Distribution, in its reasonable opinion, to come into conflict with any provision of statute, the Licence or other regulation.

The Licence imposes on Transco Distribution an obligation to operate the system in an efficient, economic and co-ordinated manner. Ofgem has indicated that it would expect the obligation to be satisfied where Transco Distribution is responding to the commercial incentives in its SO incentive schemes. However Ofgem has indicated that Transco Distribution's behaviour should be appropriately constrained by the economic, efficient and coordinated obligation, for example, when its commercial incentives are not biting - such as when revenues relating to one or more incentive schemes are, or are expected to be, either greater than the incentive cap or lower than the incentive collar.

3. Change Process

The Guidelines have been developed by Transco Distribution and the form of the Guidelines has been approved by the Authority. It may only be modified in accordance with the processes set out in the Special Condition. Transco Distribution will monitor the operation and application of the Guidelines and it is Transco Distribution's intention that it will meet with Users on a periodic basis to review the operation of the Guidelines and, where appropriate, to consider modifications to the Guidelines.

The Guidelines make reference to a number of provisions contained in the Network Code. In the event that any of the relevant provisions in the Network Code are modified it may become necessary for Transco Distribution to seek an amendment to the Guidelines in order that it remains consistent with the Network Code. Prior to any such amendment the Network Code shall take precedence over the Guidelines.

For the avoidance of doubt, the Guidelines do not form part of the Network Code.

PART B: GENERAL PRINCIPLES

1. System Management Services

The services that Transco Distribution needs to procure in order to operate its Distribution pipe-line system constitute System Management Services.

Such services may be provided from a variety of sources. For example Transco Distribution may access existing mechanisms or markets. This might for example be via a Trading system or alternatively it may be via other contractual frameworks.

1.1 Trading Systems

Trading systems are defined as electronic trading mechanisms. Transco Distribution may have access to any trading system that may assist in the provision of services to support the Transco Distribution System Management role.

This could include access to markets and mechanisms operated by third parties as well as access to mechanisms that might be operated by Transco Distribution .

Such markets/mechanisms will enable the provision of services to Transco Distribution. For example, the on the day commodity market (OCM) operated by APX is one such trading system.

Where Transco Distribution transacts on Trading Systems provided by third parties it will transact on exactly the same basis as other participants, including any provisions applicable in respect of credit arrangements and information release.

1.2 Other System Management Services

These services may be physically or financially based services or contracts.

These services may include:

- Forwards, futures and options contracts for (shrinkage) gas
- Capacity services at entry or exit from the network
- storage or other gas facility based services
- demand side management contracts.

Physically based services will be focused on enabling Transco Distribution to buy a right to physically adjust gas flows at points on the system with the counterparty having an obligation to deliver such change. It is likely that such services will primarily be of interest to Transco Distribution in its System Management role and that few, if any, other industry players will have such requirements.

2. Procurement Principles

When procuring System Management Services, Transco Distribution will apply the following principles:

- Without prejudice to the factors below and after having taken relevant price and operational differences into account, Transco Distribution shall contract for System Management Services in a manner that is consistent with the Competition Act and Transco Distribution's statutory obligations.
- Transco Distribution will be influenced by the terms in the Licence relating to the SO incentive schemes and the economic, efficient and co-ordinated operation obligation.
- In contracting for the provision of System Management Services Transco Distribution will endeavour to purchase from the most economic and efficient sources available to Transco Distribution having regard to the attributes of such service and delivery.

In assessing the reliability of the service Transco Distribution will consider, for example, the historical performance of the provider and an assessment of the prospective effectiveness of the procured service.

Where there is, or is likely to be in the future, sufficient competition in the provision of a System Management Service Transco Distribution would normally seek to procure that service via an appropriate competitive process (identified in Table 1) or market mechanism, as described in Part D of this document. In such instances Transco Distribution shall provide a statement indicating the processes and terms under which contracts will be awarded.

Copies of these statements are available from the Information Provision Contact listed in Part E of this document.

- If Transco Distribution considers that there is insufficient competition in the provision of a System Management Service, or where Transco Distribution considers it to be more economic or efficient to do so, Transco Distribution may contract for such provision on a negotiated bilateral basis. Transco Distribution may wish to stimulate development of secondary markets by the use of bilateral contracts.
- If System Management Services of high value are required over a relatively long term, Transco Distribution will ordinarily advertise that requirement to market participants.

3. Tool Usage

Transco Distribution's consideration of whether to undertake actions within or outside of the trading systems will be based on an assessment of the level and cost of services expected to be available within such trading systems.

Contracts will be entered into to complement or substitute for trading system use when

- Accessing services prescribed in Network Code, or
- Transco Distribution anticipates insufficient service availability via the trading systems to meet system security requirements, or
- if Transco Distribution considers that such contracts will lead to a reduction in overall cost or a more favourable Transco Distribution and/or community risk profile, or
- to provide operational characteristics that are not available through the trading systems.

When considering what actions will be undertaken Transco Distribution will consider the use of all available System Management Services including forwards and options agreements.

When Transco Distribution considers it likely to lead to economic and efficient outcomes, it may elect to trade on any other market or mechanism available to other market participants, or procure and trade any contract affording value arising from storage, gas, capacity, any related derivative or supply/demand management service, having regard to the Special Condition.

PART C: SYSTEM MANAGEMENT SERVICES REQUIRED

1. Types of System Management Services

Transco Distribution is interested in procuring System Management Services to enable it to fulfil its statutory, regulatory and Licence obligations. Such procurement may include procurement in respect of satisfying requirements in respect of :

- Shrinkage
- DN Entry Capacity Management
- Storage
- Interruption.

2. Description of System Management Services

2.1 Use of Services

Transco Distribution is encouraged to utilise a broad range of tools for system management purposes, taking account of Licence obligations, under its incentive schemes.

Transco Distribution is prohibited from purchasing or otherwise trading energy/capacity except pursuant to the procurement or use of services in respect of facilitating shrinkage procurement and constraint management (as defined in Standard Special Condition D4]).

2.2 Procurement & Trading Arrangements

Reasons why Transco Distribution may buy or sell gas or procure capacity or indeed any other tools that are developed subsequent to the approval of this document include:

- To manage both the community and Transco Distribution's exposure to system management costs through the use of risk management tools and strategies.
- To provide additional and complementary contractual arrangements to meet requirements to maintain a safe and secure system using procured tools rather than undue dependence on tools secured close to the time of gas flow or administratively based approaches (where appropriate). The services described above may fulfil this requirement providing either operational and/or financial risk mitigation for both the System Operator and system users.
- To reduce the total cost of system management of the pipe-line system compared with sole reliance upon prompt mechanisms.
- To better manage the financial risks/rewards associated with system

management.

- To enable commercial optimisation across different system management instruments in order to yield a lower total cost or improved risk/reward position.
- To access or develop greater liquidity in commodity markets and to promote new sources of flexibility.
- To enable delivery of gas to networks and supply points connected to the Distribution system consistent with the Gas Safety Management Regulations under demand conditions as stipulated by the Licence.

PART D: PROCUREMENT MECHANISMS

1. Procurement Process

1.1 Physical Service Provision

Where Transco Distribution is involved in procuring physical services and sufficient competition exists, Transco Distribution will normally seek to contract for services via some form of market mechanism. In other circumstances, bilateral contracts may be entered into with the service providers. In all circumstances Transco Distribution will be mindful of its Licence obligations when entering into these agreements.

Use of Existing Markets/Mechanisms

Wherever an existing market or mechanism is available Transco Distribution will consider the use of such tools if appropriate. However Transco Distribution appreciates that where it requires physical services it is probable that Transco Distribution requirements are likely to be different from most other players and hence it may be the only player. As the sole purchaser, Transco Distribution may need to conduct a competitive procurement process.

Competitive Procurement Mechanisms

This will normally be a tender based process for the selection and award of service contracts. Transco Distribution might seek expressions of interest or consultation with potential service providers ahead of invoking formal tendering processes. The procurement process will normally include:

- a statement of service requirements;
- the issuing of invitation to tender documentation, which will endeavour to provide sufficient information to allow the provision of a service offer to be made, including standard contract terms and conditions;
- arrangements for governance of the process;
- a statement of principles and criteria that Transco Distribution will consider when evaluating the awarding of contracts.

Bilateral Contracts

Where Transco Distribution considers there is insufficient competition to generate an efficient tender outcome (taking into account locational factors where necessary, or because of special technical requirements of the desired service, or where some form of monopoly exists, or in view of the unique characteristics of certain individual providers) it may be appropriate to consider bilateral arrangements.

Where Transco Distribution considers there to be limited competition, Transco Distribution may:

- Contact those service providers believed to be capable of providing the required service or who have expressed an interest in providing the service in order to establish whether they wish to enter into a contract for the service in question; and
- Offer non-discriminatory terms for the acquisition of the service.

However, if there is insufficient time to identify and contact other providers, Transco Distribution reserves the right to contract as appropriate to meet system security requirements.

The use of bilateral contracts may be more efficient or economic or beneficial to long term service or market development. This may, for example, be due to special operational requirements of the desired service or where it may stimulate liquidity or interest in shippers offering services in the longer term.

Transco Distribution will engage with counterparties on a bilateral basis consistent with the Competition Act and its obligation to operate in an economic, efficient and coordinated manner.

Market Development

Transco Distribution will endeavour to play its part in developing markets, liquidity and standardised services and contracts where these are consistent with its obligations. This may involve attempts to stimulate the market through the development of bilateral contracts, as might be expected in emergent markets.

1.2 Other Service Provision

In many areas Transco Distribution will be transacting for services that essentially involve the purchase of a commodity, for example gas at the NBP.

These are markets in which Transco Distribution is not expected to be dominant and Transco Distribution expects to trade in these markets in a similar way to other market players. Transco Distribution will therefore transact on exchanges, or via brokers or via any other means that other players use to buy or sell the commodity.

2. Credit Risk

Transco Distribution will evolve credit risk management strategies that may differ in respect of whether Transco Distribution faces full exposure, or whether it shares the exposure with Users.

Where Transco Distribution has, or is expected to face, full exposure then the credit risk policy will be a matter entirely for Transco Distribution.

Where Transco Distribution has a shared exposure, Transco Distribution will have a policy that is known to Users. From time to time Transco Distribution will seek views from the community as to the effectiveness and/or appropriateness of the policy. Such views will then inform the policy to be applied.

3. Information Release

3.1 Tender Processes

Transco Distribution would normally anticipate issuing information about tender processes in respect of services of a physical nature.

As a general principle where Transco Distribution is involved in competitive tender process, it would expect to publish information in a timely manner about the outcome of the tender process.

3.2 Procurement Guidelines Report

Transco Distribution will provide an annual report during April detailing procurement outcomes in the previous year, as required under paragraph 4 of the Special Condition of its licence.

3.3 Other Procurement Processes

Transco Distribution believes that, as a general principle, it should have discretion as to whether it publishes information about the results of its procurement processes.

Transco Distribution's assessment will be guided by considerations such as:

- The extent of competition known or considered likely to exist
- The normal practise within a particular market.

The extent of information release will be designed to encourage, in Transco Distribution's view, the most economic and efficient outcomes.

Transco Distribution believes it should have similar flexibility and obligations as any other market player in respect to information provision. For example, where the market is largely conducted on the basis of bilateral trades Transco Distribution should be able to use such methods and have similar commercial freedom to any other player in respect of what information about its trading position is released. Similarly where Transco Distribution is transacting on third party Trading Systems, such participation will be on the basis of the same terms that would be available to any other user of that system.

Invoice Support

Sufficient information to establish basis for any charges will either be released to support invoiced amounts or made available to an industry or Ofgem appointed auditor to confirm the validity of the charges.

4. Procurement Communication Media

Wherever practical, and where consistent with economic and efficient operation, Transco Distribution shall communicate any service requirement by contacting those parties that it believes may be interested in providing the service, including any existing or past service providers, and anyone that has expressed a prior interest in providing such services in the future. In addition, notification of tenders will normally be advertised as appropriate.

5. Procurement Summary

This summary Table 1 sets out the System Management Services Transco Distribution expects or intends to procure and the mechanisms by which it expect to procure such services.

Table 1 SYSTEM MANAGEMENT SERVICES SUMMARY TABLE

SERVICES	ANTICIPATED APPLICATION	MEANS OF PROCUREMENT	TIMESCALES
SYSTEM MANAGEMENT SERVICES			
Energy (gas)	<ul style="list-style-type: none"> • Shrinkage 	<p>On the day Commodity Market (title, physical and locational)</p> <p>Over The Counter / brokered markets</p> <p>Other exchanges (e.g. ICE, IPE, Spectron Online)</p> <p>Tenders</p> <p>Bilateral agreements</p>	Ongoing
Capacity	<ul style="list-style-type: none"> • NTS (Flat) Exit Capacity • NTS (Flexible) Capacity • Storage Services 	<p>Network Code Arrangements</p> <p>Tenders</p> <p>Bilateral agreements</p>	Ongoing
Supply & Demand-side Management tools (including Interruption Services)	Exit capacity management	Network Code Arrangements	As required

PART E: INFORMATION PROVISION

1. General Provisions

Transco Distribution will normally publish information on the System Management Services that it intends to procure. In doing so Transco Distribution will seek to provide market participants and other interested parties with sufficient information whilst endeavouring not to compromise the commercial position of any contracting party, including Transco Distribution.

2. Information Provision Contacts

All queries regarding the provision of System Management Services Transco Distribution intends to procure should be made, in the first instance, to:

Peter Rayson
Commercial Manager
UK Distribution
National Grid Transco
NGT House
Warwick Technology Park
Gallows Hill
Warwick
CV34 6DA
Tel. 01926 655178
E-mail: peter.rayson@uk.ngrid.com

3. Information Provision Detail

In circumstances where tenders are held Transco Distribution will publish, where appropriate, information on the outcome of these processes via market reports, which are available on Transco's website.

4. Disclaimer

All information published or otherwise made available to market participants and other interested parties pursuant to these Procurement Guidelines is done so in good faith. However, no warranty or representation is given by Transco Distribution, its officers, employees or agents as to the accuracy or completeness of any such information, nor is any warranty or representation given that there are no matters material to any such information not contained or referred to therein. Accordingly, no liability can be accepted for any error, misstatement or omission in fraudulently.